

DEPARTMENT OF STATE REVENUE

Revenue Ruling # 2019-11ST
February 24, 2020

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ISSUES

Sales and Use Tax - Tangible Personal Property Converted into Real Property

Authority: [IC 6-2.5-1-14.7](#); [IC 6-2.5-1-14.9](#); [IC 6-2.5-1-27](#); [IC 6-2.5-1-27.7](#); [IC 6-2.5-2-1](#); [IC 6-2.5-2-2](#); [IC 6-2.5-3-2](#); [IC 6-2.5-4-1](#); [IC 6-2.5-4-9](#); Sales Tax Information Bulletin #60 (November 2017).

A taxpayer ("Contractor") is seeking an opinion as to whether its fabrication labor is subject to sales tax under a lump sum contract.

STATEMENT OF FACTS

Contractor is an Indiana corporation that fabricates different stone products, including countertops, which Contractor also installs into real property. One of Contractor's customers would like Contractor to switch its contract structure from a time and material contract to a lump sum contract in order to reduce the customer's tax burden. However, Contractor was audited by the department over a decade ago, where it was determined that Contractor was to charge sales tax on any material, retail items and any fabrication labor that was performed prior to delivering its products to the jobsite. Contractor would like to switch all of its contracts and invoices to lump sum contracts, and would like confirmation from the department that their conversion or fabrication labor is not subject to Indiana sales tax.

DISCUSSION

Pursuant to [IC 6-2.5-2-1\(a\)](#) and [IC 6-2.5-2-2\(a\)](#), sales tax is imposed on retail transactions made in Indiana. [IC 6-2.5-4-1\(a\)](#) provides that "[a] person is a retail merchant making a retail transaction when he engages in selling at retail." A retail transaction is defined in [IC 6-2.5-4-1\(b\)](#) as the transfer, in the ordinary course of business, of tangible personal property for consideration. [IC 6-2.5-4-1](#) goes on to provide in pertinent part:

For purposes of determining what constitutes selling at retail, it does not matter whether:

- ...
 - (2) the property is transferred alone or in conjunction with other property or services . . .
 - (e) The gross retail income received from selling at retail is only taxable under this article to the extent that the income represents:
 - (1) the price of the property transferred, without the rendition of any service; and
 - (2) except as provided in subsection (g), any bona fide charges which are made for preparation, fabrication, alteration, modification, finishing, completion, delivery, or other service performed in respect to the property transferred before its transfer and which are separately stated on the transferor's records.
- For purposes of this subsection, a transfer is considered to have occurred after delivery of the property to the purchaser.

"Tangible personal property" is defined in [IC 6-2.5-1-27](#) as:

- . . . personal property that:
 - (1) can be seen, weighed, measured, felt, or touched; or
 - (2) is in any other manner perceptible to the senses.

The term includes electricity, water, gas, steam, and prewritten computer software.

[IC 6-2.5-4-9](#) explains a contractor's sales and use tax liability in construction contracts as follows:

- (a) A person is a retail merchant making a retail transaction when the person sells tangible personal property which:

- (1) is to be added to a structure or facility by the purchaser; and
 - (2) after its addition to the structure or facility, would become a part of the real estate on which the structure or facility is located.
- (b) A contractor is a retail merchant making a retail transaction when the contractor:
- (1) disposes of tangible personal property; or
 - (2) converts tangible personal property into real property;
- under a time and material contract. As such a retail merchant, a contractor described in this subsection shall collect, as an agent of the state, the state gross retail tax on the resale of the construction material and remit the state gross retail tax as provided in this article.
- (c) Notwithstanding subsections (a) and (b), a transaction described in subsection (a) or (b) is not a retail transaction, if the ultimate purchaser or recipient of the property to be added to the structure or facility would be exempt from the state gross retail and use taxes if that purchaser or recipient had directly purchased the property from the supplier for addition to the structure or facility.

A contractor's use tax responsibilities with respect to the purchase, use, and sale of construction material are found in subsection (c) of [IC 6-2.5-3-2](#), which provides the following:

- (c) The use tax is imposed on a contractor's conversion of construction material into real property if that construction material was purchased by the contractor. However, the use tax does not apply to conversions of construction material described in this subsection, if:
- (1) the state gross retail or use tax has been previously imposed on the contractor's acquisition or use of that construction material;
 - (2) the person for whom the construction material is being converted could have purchased the material exempt from the state gross retail and use taxes, as evidenced by a properly issued exemption certificate, if that person had directly purchased the construction material from a retail merchant in a retail transaction; or
 - (3) the conversion of the construction material into real property is governed by a time and material contract as described in [IC 6-2.5-4-9\(b\)](#).

"Construction material" is defined in [IC 6-2.5-1-14.7](#) as "any tangible personal property to be converted into real property." [IC 6-2.5-1-14.9](#) defines "Contractor" as "any person engaged in converting construction material into real property on behalf of another person. The term includes, but is not limited to, general or prime contractors, subcontractors, and specialty contractors." Finally, "time and material contract" is defined at [IC 6-2.5-1-27.7](#) to mean "a contract in which the cost of construction material and the cost of labor or other charges are stated separately."

There is a difference in the tax collection and remittance requirements for construction material purchased by a contractor, which depends on whether the contractor is operating under a time and material contract or a non-time and material contract (in this case, a lump sum contract). The Department's guidance on the topic is found in Sales Tax Information Bulletin #60 (November 2017). In interpreting [IC 6-2.5-3-2\(c\)](#), the bulletin provides that when operating under a lump sum contract, contractors "purchase construction material for their own use or consumption in the fulfillment of contractual obligations to provide real property improvement services." Therefore, when a contractor operates this way, they "are not reselling construction material and should not charge their customers sales tax." *Id.* A lump sum contractor's tax obligations would be the following:

- (1) pay sales tax at the time the construction material is purchased; or
- (2) self-assess and remit use tax at the time the construction material is converted into real property if that construction material was purchased or otherwise acquired without paying tax.

On the other hand, in interpreting [IC 6-2.5-4-9\(b\)](#), Sales Tax Information Bulletin #60 provides that "contractors are retail merchants selling construction material when they (1) dispose of, or (2) convert construction material into real property under a time and material contract." *Id.* Due to sales of tangible personal property being subject to sales tax, which includes construction materials, "contractors converting construction material into real property under a time and material contract must collect and remit sales tax on the material portion of their contracts." *Id.*

Therefore, if Contractor begins to operate using lump sum contracts, Contractor would not be considered a retail merchant making a retail transaction of countertops and it would not collect sales tax on its contracts and invoices with its customers. Contractor would instead pay sales tax on its own purchase of construction material, or remit use tax when Contractor incorporates the countertops into real property through installation if sales tax had not previously been paid. Likewise, because it is not selling at retail, Contractor would not be eligible for any exemptions for manufacturing, production, or fabrication, as Contractor would not be considered selling the item it

is producing.

Furthermore, when operating under a lump sum contract, contractors typically charge a single amount that encompasses both the construction materials and any labor involved, which would be reflected on invoices as well. In other words, it is assumed that Contractor would not list separate charges for labor and materials on its contracts or invoices. By not operating under a time and material contract, where those charges would be separated, Contractor would not statutorily be considered a retail merchant making a retail transaction. As such, Contractor would not charge sales tax on any part or percentage of its invoiced amount for the countertops, including any part that could be considered labor for fabrication, preparation, and other activities made prior to delivery to its customers. The reason that [IC 6-2.5-4-1](#)(e) requires separated "bona fide" charges for fabrication, preparation and other activities to be subject to sales tax is to make clear that if a manufacturer or fabricator of tangible personal property did separate those charges on an invoice, they would still be subject to Indiana sales tax. However, because Contractor will not operate under a time and materials contract and will not separate the charges for labor and construction materials on its contracts or invoices for the countertops, Contractor will not be required to collect sales tax on the single amount charged to its customers. This includes any part that includes installation labor, because even though its charges for installation labor are not separately stated, which would normally make such charges subject to sales tax pursuant to [IC 6-2.5-1-5](#)(b), the transaction is not considered a retail transaction subject to sales tax.

RULING

When Contractor operates under a non-time and materials contract in which it charges a single amount for both the countertops and the fabrication and installation of the countertops on its contracts and invoices, they are statutorily not considered a retail merchant making a retail transaction. Therefore, Contractor is not required to collect sales tax on any portion of the amount charged to its customers, including for labor that represents fabrication, preparation, and installation. However, Contractor is also no longer eligible to claim the exemption for tools, equipment, and machinery directly used in the direct manufacturing, production, or fabrication of the countertops pursuant to [IC 6-2.5-5-3](#), or for any materials directly consumed in direct production of the countertops pursuant to [IC 6-2.5-5-1](#), as Contractor would not be considered selling the item it is producing.

CAVEAT

This ruling is issued to the taxpayer requesting it on the assumption that the taxpayer's facts and circumstances as stated herein are correct. If the facts and circumstances given are not correct, or if they change, then the taxpayer requesting this ruling may not rely on it. However, other taxpayers with substantially identical factual situations may rely on this ruling for informational purposes in preparing returns and making tax decisions. If a taxpayer relies on this ruling and the Department discovers, upon examination, that the fact situation of the taxpayer is different in any material respect from the facts and circumstances given in this ruling, then the ruling will not afford the taxpayer any protection. It should be noted that subsequent to the publication of this ruling a change in statute, regulation, or case law could void the ruling. If this occurs, the ruling will not afford the taxpayer any protection.

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